

Before the  
Federal Communications Commission  
Washington, D. C. 20554

In the Matter of )  
)  
Petition for Rulemaking to Amend )  
Part 32 of the Commission's Rules, )  
Uniform System of Accounts for )  
Class A and Class B Telephone )  
Companies to Adopt the Accounting )  
for Software Required By Statement )  
of Position 98-1 )

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

**PETITION FOR RULEMAKING OF BELLSOUTH AND BELL ATLANTIC**

BellSouth Corporation and BellSouth Telecommunications, Inc. ("BellSouth") and the Bell Atlantic telephone companies<sup>1</sup> ("Joint Petitioners") respectively request that the Commission establish a rulemaking proceeding to amend its existing Part 32 rules concerning the Uniform System of Accounts For Telecommunications Companies in order to accommodate recent changes in Generally Accepted Accounting Principles (GAAP) with regard to the accounting to be applied to software acquisition and development costs. The petitioners also seek waiver of the requirement to perform a revenue requirement study.

<sup>1</sup> The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, DC, Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

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I. Reason for the Request

On March 4, 1998, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) issued a Statement of Position (SOP) 98-1 entitled *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. This SOP provides guidance on accounting for the costs of computer software developed or obtained for internal use. Effective December 15, 1998, the SOP changes the accounting for the cost of software obtained or developed for internal use from the predominant industry practice of expensing to a practice of capitalizing the cost. As a result, local exchange carriers will have to begin capitalizing these costs in their *financial* accounting records. In order for the Commission's requirements governing these same carriers' *regulatory* accounting records to conform to GAAP, the Commission must authorize this same change to its rules. FCC adoption of the rule will avoid the unnecessary burden of separate regulatory accounting treatment of these costs. At the same time, the Commission should waive the requirement for a revenue requirement study. This requirement is a holdover from rate of return regulation and serves no useful purpose for price cap regulated carriers.

II. Current Accounting Required By Part 32

Prior to the implementation of Part 32, the telecommunications industry's long standing practice was to expense the cost of all software acquired or purchased for internal use. The Commission modified this long standing industry practice and required

carriers to capitalize the cost of initial operating system software.<sup>2</sup> In Responsible Accounting Officer Letter (RAO Letter) 6, the FCC published an items list for the Part 32 plant accounts. The only software included as capitalized cost was initial operating system software.

### III. SOP Requirements

On a going-forward basis, the SOP requires that entities capitalize all initial software developed or obtained for internal use. Capitalized costs related to internally developed software are limited to the direct cost of internal use software plus interest (determined in accordance with FASB Statement No. 34) incurred during the development stage. Direct costs are defined as external direct costs of materials and services consumed in development efforts as well as payroll and payroll related costs for employees who are directly associated with and who devote time to the project, to the extent of the time spent directly on the internal-use computer software project. The SOP specifically excludes capitalization of indirect costs (i.e., general and administrative costs and overhead costs).

The SOP requires that capitalization should begin when (a) the preliminary project stage is completed; and, (b) management implicitly or explicitly authorizes and commits to funding a computer software project and it is probable that the project will be completed and the software will be used to perform the function intended. The SOP requires that capitalization of costs should stop no later than the point at which a computer software project is substantially complete and ready for its intended use.

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<sup>2</sup> *Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules)* ("Revision of the Uniform System of Accounts"), 60 Rad. Reg. 2d (P&F) 1111, ¶ 132 (1986).

The SOP requires upgrades and enhancements to existing internal-use software be capitalized if they result in additional functionality. Functionality is defined as the ability of the software to perform tasks that it was previously incapable of performing. The SOP specifically excludes capitalization of costs incurred to increase the efficiency or extend the useful life of internal-use software. Lastly, the SOP requires that capitalized software be amortized over the economic life of the software.

#### IV. Requested Changes in Part 32 Classification of Software

Joint Petitioners request that the cost of software capitalized be classified as an intangible asset to account 32.2690, *Intangibles*. Support for this request is found in accounting guidance provided by authoritative standard setting bodies as to what constitutes an intangible asset. Accounting Principles Board Opinion No. 17 (APB 17), *Intangible Assets*, issued in August 1970, discusses the characteristics that separate an intangible asset from a tangible asset:

“... its lack of physical qualities makes evidence of its existence elusive, its value is often difficult to estimate, and its useful life may be indeterminable.”<sup>3</sup>

Software is defined as “... the entire set of programs, procedures, and related documentation associated with a system and especially a computer system.”<sup>4</sup> Generally,

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<sup>3</sup> APB 17, *Intangible Assets*, ¶ 2.

<sup>4</sup> Merriam-Webster’s Collegiate Dictionary, (10<sup>th</sup> ed., Merriam-Webster, Inc. 1994).

software acquired or obtained for internal use has no physical quality other than the medium, *i.e.*, tapes or disks on which the software is stored. The true value of the software is the tasks the set of instructions will perform. Software is directly impacted by the types of external factors listed in APB 17, such as: (1) legal, regulatory or contractual provisions; (2) provisions for renewal or extension; and, (3) effects of obsolescence, demand, competition, and other economic factors.

Assets frequently given as examples of intangibles, such as patents, copyrights, leases, licenses or trademarks, generally represent rights, *i.e.*, the right to use, produce, sell or operate something. Right-to-use (RTU) paid under agreements for the use of network software on a telecommunications switch fits this category as does fees paid for the right to use general and administrative (G&A) software licenses, *e.g.*, spreadsheet and word processing packages. The user does not acquire ownership of the software, but the right to use the software according to the terms of the license agreement.

For the above reasons, Joint Petitioners request the Commission modify Part 32 of the rules so that the cost of capitalized internal-use software may be classified as an intangible in Account 2690.<sup>5</sup> Suggested language changes to section 32.2690 to accomplish the above are shown in attachment 1. In addition to language changes to section 32.2690, the petitioners have identified several other Part 32 paragraphs which require language revisions, additions or deletions in order to integrate the SOP

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<sup>5</sup> Capitalization of software costs as an intangible is not an unfamiliar concept to the Commission. In *Revision of the Uniform System of Accounts Further Notice of Proposed Rulemaking*, 100 FCC.2d 480 (1985), the Commission's original position required that software be capitalized in Account 2690, Intangibles. The Commission later revised its position in order to conform with GAAP. Because GAAP is now changing, the Commission should also change its rules.

requirements into Part 32 rules. Those suggested changes also are detailed in attachment 1.

V. Revenue Requirement Study

Joint Petitioners also seek a waiver of the Part 32 requirement that when a change in an accounting standard is to be adopted, a revenue requirement study must be provided.<sup>6</sup> The Commission has held that a waiver for good cause will be granted where there are special circumstances that warrant a deviation from the rule and such deviation is in the public interest.<sup>7</sup> Here, there are special circumstances because the provision no longer serves a useful regulatory purpose for price cap regulated carriers. The Commission has modified the price cap rules to exclude exogenous treatment for accounting changes that have no cash flow impact.<sup>8</sup> As a result, the accounting change has no rate impacts and a revenue requirement study would serve no useful purpose.<sup>9</sup> Because no other entity implementing this accounting change for software will be required to perform these studies, the requirement places a unique regulatory burden on carriers. As a result, it is in the public interest to waive the rule and imposition of this obsolete burden would only serve to undermine competition.

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<sup>6</sup> 47 C.F.R. § 32.16(a)

<sup>7</sup> *See, e.g., Provision of Access for 800 Service*, 7 FCC Rcd 5046, 5048 (1992).

<sup>8</sup> *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8961, ¶¶ 292-96 (1995).

<sup>9</sup> *See FCC Form 393*, 9 FCC Rcd 2190 (1994) (rule for format of filing waived for entire industry where requirement served no useful purpose).

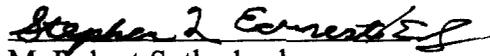
VI. Effective Date of the Rule Change

The accounting changes required by SOP 98-1 must be implemented by Joint Petitioners for all financial statements issued for fiscal years beginning after December 15, 1998 for external financial reporting purposes. Thus, the Commission should expedite proceedings to make the changes to Part 32 accounting rules requested in this Petition. Joint Petitioners request that the Commission issue a Notice of Proposed Rule Making (NPRM) on an accelerated basis such that the Commission can issue an order prior to December 31, 1998. In the unlikely event that an order in response to this petition can not be issued by December 31, 1998, the FCC should issue interim guidance permitting the Petitioners to record software costs capitalized on their GAAP books as an intangible asset in their Part 32 books of account. Absent receipt of an order or the interim guidance requested above, Joint Petitioners will be in the untenable position of expensing the cost of internal use software in their Part 32 books and capitalizing this same cost in their GAAP books beginning January 1, 1999. Although 47 U.S.C. § 220(g) requires the Commission to provide carriers with six (6) months advance notice before implementing an accounting change, nothing prevents earlier implementation by a carrier on a voluntary basis. Therefore, the Commission should allow carriers to implement this accounting change on January 1, 1999, regardless of the effective date of the order.

CONCLUSION

For the foregoing reasons, Joint Petitioners request that the commission publish a notice of proposed rulemaking which recommends changes in its Part 32 rules in order to accommodate SOP 98-1 requirements.

Respectfully submitted,



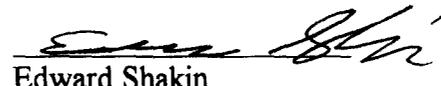
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August 3, 1998

## Changes Required To Part 32 To Incorporate

## AICPA Statement of Position on Accounting for Software 98-1 (SOP 98-1)

Current Part 32 Text	Changes Required to Implement SOP 98-1 ( <i>changes bolded</i> )
<p>§ 32.2000 Instructions for telecommunications plant accounts (a) * * * * *</p> <p>(4) The cost of the individual items of equipment, classifiable to Accounts 2112, Motor vehicles; 2113, Aircraft; 2114, Special purpose vehicles; 2115, Garage work equipment; 2116, Other work equipment; 2122, Furniture; 2123, Office equipment; and 2124, General purpose computers, costing \$2,000 or less or having a life less than one year shall be charged to the applicable Plant Specific Operations Expense accounts, except for personal computers falling within Account 2124. Personal computers classifiable to Account 2124, with a total cost for all components, including initial operating software, of \$500 or less shall be charged to the applicable Plant Specific Operations Expense accounts. If the aggregate investment in the items is relatively large at the time of acquisition, such amounts shall be maintained in an applicable material and supplies account until items are used.</p>	<p>§ 32.2000 Instructions for telecommunications plant accounts (a) * * * * *</p> <p>(4) The cost of the individual items of equipment, classifiable to Accounts 2112, Motor vehicles; 2113, Aircraft; 2114, Special purpose vehicles; 2115, Garage work equipment; 2116, Other work equipment; 2122, Furniture; 2123, Office equipment; 2124, General purpose computers; <b>and software classified to 2690, Intangibles</b>, costing \$2,000 or less or having a life less than one year shall be charged to the applicable [ ... ] expense accounts, except for personal computers falling within Account 2124. Personal computers classifiable to Account 2124, with a total cost for all components, <b>not including software</b>, of \$500 or less shall be charged to the applicable Plant Specific Operations Expense accounts. If the aggregate investment in the items is relatively large at the time of acquisition, such amounts shall be maintained in an applicable material and supplies account until items are used.</p>
<p>§ 32.2000 Instructions for telecommunications plant accounts</p> <p>(i) Accounting for software. The original cost of initial operating system software for computers shall be classified to the same account as the associated hardware whether acquired separately or in conjunction with the associated hardware.</p>	<p>§ 32.2000 Instructions for telecommunications plant accounts</p> <p>(i) Accounting for software.  <b>(1) Capitalizable costs of operating and application system software should be charged to Account 2690. (Note also § 32.2000(a)(4) and § 32.2003(a)(2).)</b>  <b>(2) Costs chargeable to Account 2690 include the direct cost of materials and services consumed to develop or obtain the software, and payroll and payroll-related costs of employees who spend time directly on software development.</b>  <b>(3) Costs of software upgrades and enhancements should be charged to Account 2690 when these changes enable the software to perform tasks it was unable to perform prior to the enhancement or upgrade.</b>  <b>(4) Costs of capitalizable software shall include an allowance for funds used during the development period. (Note also § 32.2000(c)(2)(c).)</b>  <b>(5) Capitalizable software costs do not include training, maintenance, general and administrative costs, or overhead costs.</b>  <b>(6) The costs of modifications that make software run faster, more efficiently, or extend its life, and the costs of upgrades and enhancements that are not specifically identified with a particular software package or module, should be charged to the applicable expense account with which the software is associated.</b></p>

Changes Required To Part 32 To Incorporate

AICPA Statement of Position on Accounting for Software 98-1 (SOP 98-1)

<p>§ 32.2003 Telecommunications plant under construction.</p> <p>(a) This account shall include the original cost of construction projects. (Note also § 32.2000(c).)</p> <p>*****</p> <p>(d) When any telecommunications plant, the cost of which has been included in this account, is completed ready for service, the cost thereto shall be credited to this account, and charged to the appropriate telecommunications plant or other accounts.</p>	<p>§ 32.2003 Telecommunications plant under construction.</p> <p>(a)(1) This account shall include the original cost of construction projects. (Note also § 32.2000(c).)</p> <p><i>(a)(2) This account shall also include costs of software development projects that are classifiable to Account 2690, but that are in the application development stage and not yet ready for their intended use. (Note also § 32.2000(i) and § 32.2690(b).)</i></p> <p>*****</p> <p>(d)(1) When any telecommunications plant, the cost of which has been included in this account, is completed ready for service, the cost thereto shall be credited to this account, and charged to the appropriate telecommunications plant or other accounts.</p> <p><i>(d)(2) When any computer software project, the cost of which has been included in this account, is substantially complete and ready for its intended use, the cost thereto shall be credited to this account, and charged to Account 2690.</i></p>
<p>§ 32.2124 General purpose computers</p> <p>*****</p> <p>(c) This account shall include the original cost of initial operating system software for computers classifiable to this account whether acquired separately or in conjunction with associated hardware.</p> <p>(d) This account does not include the cost of computers, their associated peripheral devices, and their operating system software associated with switching, network signaling, network operations or other specific telecommunications plant. Such computers, peripherals, and software shall be classified to the appropriate switching, network signaling, network expense, or other plant account.</p>	<p>§ 32.2124 General purpose computers</p> <p>*****</p> <p>(c) This account <i>does not</i> include the cost of [ ... ] operating or application system software [ ... ]. <i>Such costs shall be charged to Account 2690, Intangibles, or to the appropriate expense account with which the software is associated. (Note also § 32.2000(a)(4), § 32.2000(i) and § 32.2690(d)(2).)</i></p> <p>(d) This account does not include the cost of computers and their associated peripheral devices [ ... ] associated with switching, network signaling, network operations or other specific telecommunications plant. Such computers and peripherals shall be classified to the appropriate switching, network signaling, network expense, or other plant account.</p>
<p>§ 32.2690 Intangibles</p> <p>(a) *****</p>	<p>§ 32.2690 Intangibles</p> <p>(a) *****</p>

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<p>(b) Subsidiary records for this account shall include a description of each class of intangible property.</p> <p>(c) The cost of other intangible assets having a life of one year or less shall be charged directly to Account 6564, Amortization Expense-Intangible. Such intangibles acquired at small cost may also be charged to Account 6564, irrespective of their term of life.</p>	<p><i>(b)(1) The costs of internal-use software acquired by purchase, license or other right to use, or developed internally or under contract, shall be charged to this account and amortized to expense over its estimated useful life, if such estimated useful life exceeds one year.</i></p> <p><i>(b)(2) This account also includes the costs of internal-use software upgrades and enhancements that result in additional functionality.</i></p> <p><i>(b)(3) The costs of software maintenance, unspecified upgrades and enhancements, and costs incurred under agreements that combine the costs of maintenance and unspecified upgrades and enhancements shall be charged to the expense account with which the software is associated.</i></p> <p><i>(b)(4) Amortization of software costs included in this account shall begin when the software is substantially complete and ready for its intended use. (Note also § 32.2003(d)(2).)</i></p> <p>(c) Subsidiary records for this account shall include a description of each class of intangible property.</p> <p>(d)(1) The cost of [ ... ] intangible assets <i>other than software</i> having a life of one year or less shall be charged directly to Account 6564, Amortization Expense-Intangible. Such intangibles acquired at small cost may also be charged to Account 6564, irrespective of their term of life. <i>(Note also § 32.2000(a)(4).)</i></p> <p><i>(d)(2) The cost of software having a life of one year or less shall be charged directly to the applicable expense account with which the software is associated. Individual software modules, costing \$2,000 or less may also be charged to the applicable expense account with which the software is associated, irrespective of their term of life. (Note also § 32.2000(a)(4).)</i></p>
<p>§ 32.3500      Accumulated amortization - intangible.</p> <p>(a) This account shall include the accumulated amortization associated with the investment contained in Account 2690, Intangibles.</p> <p>(b) This account shall be credited with amortization amounts concurrently charged to Account 6564, Amortization-Intangible. (Note also Account 3300, Accumulated Depreciation-Nonoperating.)</p>	<p>§ 32.3500      Accumulated amortization - intangible.</p> <p>(a) This account shall include the accumulated amortization associated with the investment contained in Account 2690, Intangibles.</p> <p>(b) This account shall be credited with amortization amounts concurrently charged to Account 6564, Amortization-Intangible. (Note also Account 3300, Accumulated Depreciation-Nonoperating.)</p> <p><i>(c) Amortization of software costs included in Account 2690 shall begin when</i></p>

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AICPA Statement of Position on Accounting for Software 98-1 (SOP 98-1)

<p>(c) When any item carried in Account 2690 is sold, relinquished, or otherwise retired from service, this account shall be charged with the cost of the retired item. Remaining amounts associated with the item shall be debited to Account 7360, Other Nonoperating Income.</p>	<p><i>the software is substantially complete and ready for its intended use.</i></p> <p><i>(d) When software that is classified to Account 2690 is retired or replaced with new software, this account shall be credited, and Account 6564, Amortization Expense - Intangible, shall be charged with the unamortized cost of the existing software.</i></p> <p>(e) When any item carried in Account 2690, <i>other than software</i>, is sold, relinquished, or otherwise retired from service, this account shall be charged with the cost of the retired item. Remaining amounts associated with the item shall be debited to Account 7360, Other Nonoperating Income.</p>
<p>§ 32.6124      General purpose computers expense.</p> <p>This account shall include costs of personnel whose principal job is the physical operation of general purpose computers and the maintenance of operating systems. This excludes the cost of preparation of input data or the use of outputs, which are chargeable to the accounts appropriate for the activities being performed. Also excluded are costs incurred in planning, developing, testing, implementing, and maintaining databases and application systems for general purpose computers. (See also Account 6724, Information Management.) Separately metered electricity for general purpose computers shall also be included in this account.</p>	<p>§ 32.6124      General purpose computers expense.</p> <p>This account shall include costs of personnel whose principal job is the physical operation of general purpose computers and the maintenance of operating systems. This excludes the cost of preparation of input data or the use of outputs which are chargeable to the accounts appropriate for the activities being performed. Also excluded are costs incurred in planning / ... / and maintaining <i>operating systems, application systems, and</i> databases / ... / for general purpose computers. (See also Accounts 2690, <i>Intangibles, and</i> 6724, Information Management.) Separately metered electricity for general purpose computers shall also be included in this account.</p>
<p>§ 32.6564      Amortization expense - intangible.</p> <p>This account shall include the amortization of costs included in Account 2690, Intangibles.</p>	<p>§ 32.6564      Amortization expense - intangible.</p> <p>(a) This account shall include the amortization of costs included in Account 2690, Intangibles.</p> <p><i>(b) Amortization of software costs included in Account 2690 shall begin when the software is substantially complete and ready for its intended use.</i></p> <p><i>(c) When software that is classified to Account 2690 is retired or replaced with new software, Account 3500, Accumulated amortization - intangible, shall be credited, and this account shall be charged with the unamortized cost of the existing software.</i></p>
<p>§ 32.6724      Information management</p> <p>... in planning, developing, testing,</p>	<p>§ 32.6724      Information management</p> <p>(a) This account shall include costs incurred in planning / ... / and maintaining</p>

## Changes Required To Part 32 To Incorporate

## AICPA Statement of Position on Accounting for Software 98-1 (SOP 98-1)

<p>implementing and maintaining databases and application systems for general purpose computers.</p>	<p><i>operating systems, application systems, and databases [ ... ] for general purpose computers.</i></p> <p><i>(b) This account does not include the capitalizable costs of developing internal-use software acquired by purchase, license or other right to use, or developed internally or under contract, or the costs of internal-use software upgrades and enhancements. Such costs shall be included in Account 2690. (Note also § 32.2000(i) and § 32.2690(d).)</i></p> <p><i>(c) This account does not include the non-capitalizable cost of computer software associated with switching, network signaling, and network operations or other specific telecommunications plant. Such software shall be classified to the appropriate Plant Operations Expense Account</i></p>
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